FEDERAL OPEN MARKET COMMITTEE MEETING TRANSCRIPTS

Prefatorv Note

The 1995 transcripts, prepared shortly after each meeting or conference call, were produced by the FOMC Secretariat from recorded proceedings of the meetings. The Secretariat lightly edited the speakers' original words to facilitate the reader's understanding. This editing involved some rewording, primarily for syntax purposes, or in some instances to complete or clarify a speaker's thought or to correct an obvious misstatement. But in no case did the editing alter the substance of the comments made. Meeting participants were then given an opportunity to review the transcripts for accuracy.

In a very small number of instances, passages have been deleted to protect confidential information regarding foreign central banks, businesses, and persons that are identified or identifiable. Deleted passages are indicated by gaps in the text. All information deleted in this manner is exempt from disclosure under applicable provisions of the Freedom of Information Act.

Federal Open Market Committee
Conference Call
April 28, 1995

PRESENT: Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Blinder
Mr. Hoenig
Mr. Kelley (in Houston)
Mr. Lindsey
Mr. Melzer
Ms. Minehan
Mr. Moskow
Ms. Phillips (Boston Reserve Bank)
Ms. Yellen

Messrs. Boehne, Jordan, Oltman, and Stern, Alternate Members of the Federal Open Market Committee

Messrs. Broaddus, Forrestal, and Parry, Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Ms. Browne, Messrs. T. Davis, Dewald, Hunter, Lindsey, Siegman, Slifman, Stockton, and Associate Economists

Mr. Fisher, Manager, System Open Market Account,

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Ms. Johnson, Deputy Secretary, Office of the Secretary, Board of Governors
Mr. Simpson, Associate Director, Division of Research and Statistics, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors
Ms. Carson, Staff Assistant, Office of the Secretary, Board of Governors

Messrs. Beebe, Rolnick, Rosenblum, Sniderman, and Ms. Tschinkel, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Minneapolis Dallas, Cleveland, and Atlanta, respectively

Mr. Croushore and Ms. Kreiger, Vice Presidents, Federal Reserve Banks of Philadelphia and New York, respectively

Transcript of Federal Open Market Committee Conference Call of April 28, 1995

Secretary's note: At the start of the meeting, Chairman Greenspan called on Mr. Fisher for a report on developments in domestic and foreign exchange markets. The tape was not turned on in time to capture the first few words of Mr. Fisher's report.

MR. FISHER. .... The long end of the yield curve is not much changed from where it was before the last meeting. But there has been a change over the intermeeting period at the short end of the curve. We had a slight backup in the two-to-five-year area around the time of the March meeting on data that were not quite to the market's liking. That was followed by a long, slow ride down in yields during the month of April, until around April 20, as the market began to see weaker data that seemed to conform to the view of a soft landing in sight. By the middle of April, however, the market began to get a sense that it was a little stretched. At that point the spread between the fed funds rate and the two-year rate ranged around 45 basis points. There was a lot of chatter in the market about how the market was relying on foreign central bank purchases amid unfavorable supply conditions and a lot of explanations as to why people should be interested at these levels. At that point, even as the market saw some rather weak data, we saw no further gains in prices, reflecting this sense that the market was a little stretched. In the last several days, the market has seen some data that were a little stronger than it was comfortable with. This is modest stuff; no one was shocked. But durables, homes sales, and today's Chicago Purchasing Managers' Index were all a little on the stronger side than the market was counting on. As a result, the short end began to come back up. Now the yield curve, in the two-to-thirty year range, is about where it was just before the Committee's last meeting.

Looking forward, I think the market is going to be gearing itself for the week beginning a week from today. Next Friday, we will have the employment data. The following Tuesday and Wednesday will be the quarterly refunding, which will change the supply outlook of the market. Then, on the heels of that, retail sales and inflation data will come out on Thursday and Friday. Over the few weeks between now and the next Committee meeting in Washington, I think that's the pivotal week that the bond market is going to be positioning itself for.

The dollar obviously has been under a fair amount of pressure over the period. It is interesting that for the last couple of weeks the dollar has traded in a rather narrow range. After the last meeting through the middle of April, we again had pronounced weakness against the yen. But that coincided with the yen's tremendous strength against the mark as well, and that may have contributed to the dollar stabilizing against the mark and ultimately trading in the ranges of the last couple of weeks. Right after the Committee's last meeting, we had the surprise rate cut by the Bundesbank, which did give the dollar quite a bounce from the 1.38 level up to the 1.41 level. This unwound rather quickly, in part on the fact that it was just a short covering rally but
announcement by the Bank of Japan of the adjustment in their call money rate. This adjustment was viewed as a weak substitute for a change in the official discount rate that the market had been looking

for. The dollar then began to trade off. We intervened on Monday, April 3rd, along with the Bank of Japan, and then on the 5th with the Bank of Japan and the Bundesbank. There was no tremendous rally in the dollar following those operations. But I think, following the three-way intervention on Wednesday, April 5, the dollar did develop a sense of firmness against the mark even as it began to accelerate down against the yen. The pressure against the yen continued and reached its crescendo in mid-April following the second attempt of the Japanese authorities to put out a fiscal package and to cut the official discount rate on April 14. When the announcements finally came out, the market viewed the mix of policy actions as a rehashing of prior efforts of the Japanese authorities, which in particular was lacking in any specifics whatsoever. The market came to the view that the specifics had been taken out because they were so small and lacking in meaning. That brought the dollar down briefly to the low of 79.85 on April 17. It then traded up against the yen. As I said, for the last two weeks, the dollar traded in ranges of dollar/mark 1.35 to 1.39 and dollar/yen 81 to 84.

The positive note of the period has been in Mexico City and the peso. Since the last meeting, the peso has firmed from a level of 6.80 to a high of 5.80 just two days ago. It has given up some of that gain and come back to around 6 in the last two days. There have been similar positive movements in the pricing of Mexican stocks and Brady bonds. To a great extent, this has been a reduction in the uncertainty premium--the risk that chaos could develop at any time in Mexico City--as the markets became more comfortable with themselves. While there were plenty of risks to the Mexican program going forward, it didn't appear to market participants that they would be caught by surprise on one day's notice. The downward adjustments from the high the peso reached a couple days ago seem to reflect a combination of a market that began to thin out at those higher levels--a sense that such a level is a little frothy--and the growing awareness that Monday will be May Day in Mexico, the traditional day of labor marches. Even though the officials of mainstream unions have agreed to call off their annual marches, the more left-leaning unions have not. There is considerable anxiety about protests in the streets that have helped take some of the punch out of the peso.

Let me note that on April 19, the Treasury extended an additional $3 billion to Mexico from its medium-term facility, bringing the total extended on that facility to $6 billion. One adds to that the $1 billion from the ESF in short-term money and $1 billion that has been provided from the System Account in short-term money, for a total of $8 billion outstanding at present. Next week we will be rolling over the two short-term outstandings of $1 billion each. This is the first of the three possible rollovers that were contemplated when the package was put together. You will recall that the Treasury agreed that any amount still outstanding at the end of three rollovers would have a Treasury takeout.

That's the extent of my report; I'd be happy to answer any questions.

CHAIRMAN GREENSPAN. Any questions for Peter?

MR. HOENIG. Peter, this is Tom. What are the reserves of Mexico?

MR. FISHER. I believe they currently are a tad over $6 billion. The amount may be $6-1/2 billion or approaching $7 billion. Is Charlie there? I'm sorry, I forgot.

MR. SIEGMAN. Yes. I think that's close to the number, but perhaps a bit higher.

MR. HOENIG. Thank you.

CHAIRMAN GREENSPAN. Has there been any evidence of intervention by the Bank of Mexico during this period?

MR. FISHER. Early after our last meeting, I think they did a very modest intervention; it was a token amount. Their principal form of intervention in support of the peso, as you know, would be the direct provision of dollars through the window to the Mexican banks in conjunction with maturing tesobonos. There is some sense that NAFINSA, the government holding company group, may have been purchasing dollars in the last week or so. But the Bank of Mexico itself has not yet been seen purchasing dollars.

CHAIRMAN GREENSPAN. Any further questions for Peter? If not, Don Kohn.

MR. KOHN. Mr. Chairman, in terms of money and credit flows, very briefly, things are turning out about as we expected. There has been some pickup in M1 and M2 growth. This is partly a tax story--higher payments and late refunds adding to transaction and other liquid deposits; and it's partly a story of narrowing opportunity costs as market rates have come down and deposit rates have edged up or have been about flat in recent months. We are looking at M1 growth rising from about 3/4 percent in March to 2-1/4 percent in April, and M2 growth increasing from about 2 percent in March to 2-3/4 percent in April. M3 growth has remained much stronger--6 percent in March and 5 percent in April. There we are looking at strength in bank credit. We had 8 percent growth in bank credit in March, and we have a very preliminary estimate based on about half of the month of 14 percent in April. Some of that has to do with accounting--marking-to-market and what not--but loan growth overall remains pretty strong. We had 10 percent loan growth at banks in March, and we are looking at 12 percent in April. There was a pickup in C&I loans from about 6 percent in March to approximately 13 percent, partly projected, in April. This is much less than the 22 and 24 percent growth rates we had in January and February, but it does look like C&I loan growth picked up--in the first half of April, anyhow. We have had strength in consumer loans. We are looking at about 15 percent growth in such loans in April, with or without adjustments for securitizations. We think consumer loans have been distorted by the lack of lending against refunds this year so that they were held down in February and perhaps boosted in March and April. If I look through this and go from December to April, I am looking at about 11 percent consumer loan growth at banks over that period. That's down 2 or 3 percentage points from late last year but still pretty strong. Adjusted for securitizations, I have 14 percent consumer loan growth December-to-April, and that is hardly down at all from last year. So, it looks like underlying consumer loan growth remains pretty strong.

CHAIRMAN GREENSPAN. Questions for Don?

MR. LINDSEY. Overall consumer loan growth was 14 percent and that came in spite of a reduction in car loans?

MR. KOHN. Yes. This is just at banks, Governor Lindsey. The 14 percent referred to December-to-April data to smooth through the distortions from the lack of refund loans and to include securitization effects.

CHAIRMAN GREENSPAN. Further questions? If not, Mike Prell.

MR. PRELL. We had the advance reading on first-quarter GDP today and, as you know, the 2.8 percent estimated growth in the first quarter is right in the middle of what we had projected in the January and March Greenbooks. It was very close to what we were anticipating in light of the data that had come in subsequently. Final sales were not particularly strong at 1.8 percent and, taking these numbers at face value, it would appear that the level of inventories at the end of the quarter was higher than we thought it would be. I think that reinforces our belief that in all likelihood there will be a significant drag from the inventory sector in the second quarter. We anticipate that that will be particularly evident in the auto sector, but we don't see any signs of a collapse in economic activity.

Very recent indicators, such as initial claims and the Chicago Purchasing Managers' Report that was published this morning, are consistent with a picture of moderate economic growth. We think that consumer demand will pick up substantially in the second quarter. There was only a 1-1/2 percent increase in real PCE in today's advance estimate for the first quarter, and we think we shall see a substantial acceleration. The growth of spending has been very weak relative to income over the last several months, and in light of the readings from consumer sentiment surveys, the strength of the stock market, and the distinct possibility that the pattern and timing of tax refunds could have had an effect, we are looking for good numbers in coming months from the consumer sector. The housing indicators are mixed and we expect housing starts to firm a bit from what to us was a surprisingly low March level. In the business capital spending area, the figures for the first quarter were very robust. We don't think that pace is going to be maintained, but the new orders figures and the data coming from the construction sector suggest to us that there will be a further substantial increase in capital outlays. Net exports were a significant negative in the first quarter. We don't see that persisting, given our assumptions about how the Mexico effects will play out in these data. On the whole, we are still inclined to think that growth in real GDP in the second quarter will be around 2 percent, or perhaps a shade less, as we had projected in the last Greenbook. Those numbers seem reasonable at this juncture.

On the price side, the CPI in March included an increase in the core component that was right in line with our expectations. We did see the kind of acceleration in that measure in the first quarter that we had predicted. However, in line with what we noted in the last Greenbook, when one begins to dig into the details, the pattern still is not one that clearly evidences broad inflation coming about because of pressures on resources or the pass-through of rising materials costs. I think that is a potentially interesting development. Adding to that the fact that the employment cost index figures released earlier this week were so favorable, I think one would have to say that on balance the incoming news on the inflation side is a basis for some optimism that perhaps we might have a little lower inflation in coming months than one might otherwise have expected based on a similar output path. Thank you.

CHAIRMAN GREENSPAN. Mike, do you have any sense of the implicit March-to-June real PCE changes versus December-to-March on a monthly basis?

MR. PRELL. To get the kind of growth we are anticipating, which in the last Greenbook was in the area of 3-1/2 percent and which still seems reasonable to us, we will have to see a very considerable acceleration. The numbers have been quite flat in recent months, but I can't give you the specifics.

CHAIRMAN GREENSPAN. So, it is not as though the pickup in the second quarter is already signaled in the March level.

MR. PRELL. Definitely not. We did not have arithmetic strength coming out of the quarter.

CHAIRMAN GREENSPAN. Further questions for Mike?

MR. BLINDER. I have one. How much of the export performance in Q1 do we attribute to Mexico?

MR. SIEGMAN. Mexico's trade adjustment appears to have been front-loaded to quite an extent. Mexico's trade data provide evidence that they turned around from a sizable deficit to a small surplus for the first two months, and we are the main trading partner.

MR. BLINDER. Right. The previous two quarters had real export growth in the range of 15-20 percent or something like that, and I believe this one had a very small minus.

MR. PRELL. Yes, exports were about unchanged--minus .6 percent.

MR. BLINDER. I am trying to get a feeling for whether all of that or half of that or a quarter of that could have been due to Mexico.

MR. SIEGMAN. Most of it was, but I can't give you an exact number on that.

MR. PRELL. Our sense is that the further decline in net exports is essentially a Mexico story. That would be the right order of magnitude. Net exports were down $12 billion; that's in the ballpark.

MR. BLINDER. That takes it from 15 percent to 0 or something like that? Okay, thank you.

CHAIRMAN GREENSPAN. Further questions for Mike? If not, let me give you a general review of the recent G-7 meeting and a comment on the Interim Committee discussion, which as usual did not do very much for anybody. As you may recall from the press reports prior to the G-7 meeting, there was a considerably negative tone toward the

United States. There was the possibility as we got into the meeting that there could be a little stiffness, especially considering that this was the second meeting that Secretary Rubin was involved in and the first where he was the host and the chairman.

One of the topics on which I thought he was most successful in doing that was the issue of when there would be intervention. The Japanese or the French would say that we must do something to solve this problem because the results are intolerable. Rubin would basically ask what specifically they had in mind. It is remarkable how when somebody gets very specific and starts talking about intervention, nobody believes it will work for reasons that I will get into in a minute.

The discussion about interest rates, in which no one was terribly much interested as far as United States rates are concerned, and the presumption on the deficits that Bob Rubin and I had worked out I thought turned out reasonably well, so that by the end of the meeting, there was a far more collegial atmosphere. As you may have noticed, the actual communique was relatively bland and the end result was that,

Very specifically, however, we had to confront the question who had argued that we should be moving interest rates. I argued that this really would be quite inappropriate for a number of reasons, and then I discussed the role that we perceive for interest rates in exchange markets. I pointed out that, by their very nature, all that interest rates can do is to restructure the balancing of effects that would occur as a consequence of structural problems in the various markets. I pointed out that if, for example, our problem is that of our becoming a debtor nation after being a significant creditor nation, interest rates can temporarily adjust the balance but they do not come to grips with the overall problem. I said that an extreme case of this problem is what occurred in post-World War I Britain when they had a much higher interest rate than one ordinarily would have expected because they wanted to sustain the exchange rate that they set at the end of the war at the pre-war level. This was after the exchange rate had depreciated substantially during the war. The process of trying to maintain rates as a substitute for coming to grips with the fundamentals clearly has not worked very well.

I then raised the issue he wasn't thinking of a large increase but a very small one. I said that all of our experience with interest rates in the recent period indicates that small changes do not accomplish very much. Basically one must deal with the potential, for example, of .1 percent change over a week's period being the equivalent of more than 500 basis points annually. If that we do something to show our interest in the dollar, it wasn't clear to me what he had in mind unless he wanted us to raise interest rates continuously until the dollar stabilized. I said that I did not deny that were we to go 50 basis points higher, the dollar would jump a couple of pfennings but it would then start to depreciate. What would we do for an encore?

I then went on to repeat my increasing optimism that the budget deficit will be addressed. I went through the argument that we have been debating here, namely that if we thought it was very clear that the budget deficit was creating a current account deficit and that in turn was creating significant weakness in the dollar, we presumably would have seen it in higher long-term interest rates, which we have not. But the forced assumption--that's what is involved here--is that the only way to reconcile the weakening long-term forward exchange rate for the dollar with lower nominal rates, which can only be a purchasing power issue if one goes out far enough in time, is that real long-term rates must have been going down. I then argued that that was not inconsistent with the weakness in the economy that we were observing. I went into the issue of how inventories may effect some softening in the economy. I went on further, however, to say that we have to be careful about being very sure about any of these explanations. Indeed, our inability to forecast exchange rates suggests that the complexity of the adjustment process in the exchange markets is far greater than anything we can get our hands around. Probably, we won't fully understand this phenomenon until we look at it retrospectively. It is conceivable that it may be a bubble comparable to that in the latter part of 1984 and early 1985, but we have no good way of coming at this.

I said that I thought that there was growing optimism on our coming to grips with the budget deficit. While I could not be sure, I thought things were changing in a way that I had not seen for a long while. As best I could judge, it appeared that both the President and the Congress believed that further budget deficit reduction was significantly important. Rubin then basically said that he thought I might not be all wrong on this issue; he's locked in obviously as to how much he can say publicly. He said, however, that he was not terribly sure that we are going to be able to get to a balanced budget by the year 2002 as I was indicating, and I said that that objective may be a case of hope over experience. That defused a lot of the discussion.

We had the Russians in who gave a somewhat upbeat view of where they were. We had technical discussions on GATT and potential sales of gold by the IMF for the purpose of using the interest on the sale proceeds to finance various programs in the IMF. But in general, it was a relatively shorter meeting than usual and far less difficult than I think any of us from the U.S. delegation was expecting when we went in. That's all I have to report. Does anybody have any questions?

MR. MOSKOW. Mr. Chairman, just by coincidence is visiting Chicago now and will be in our Bank this afternoon; I'll be meeting with him later. I was just wondering if he had any views that would be helpful for us to be aware of.

CHAIRMAN GREENSPAN. Remember that the sale of gold for purposes of financing certain IMF programs

Anything else? If not, we look forward to seeing you at the next meeting.

END OF SESSION